



European Securities and
Markets Authority

Consultation paper

Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **5 October 2012**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Disclaimer'.

Who should read this paper

This paper is of interest to investment firms, credit institutions or firms referred to in point (1) of Article 2(1) of Directive 2004/39/EC, third country entities from countries, the legal and supervisory framework of which has been or might be in the future declared equivalent by the Commission.

It will also be of interest to authorised primary dealers formally recognised by or on behalf of a sovereign issuer. National and European trade associations, operators of trading venues and consumer bodies may also be interested in this paper.

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I. Executive Summary

Reasons for publication

This paper is published to consult on draft ESMA guidelines in accordance with Article 16(2) of the ESMA Regulation.

Contents

Section II provides background information and explains the purpose of the Guidelines

Section III clarifies the definition and the scope of the exemption for market making activities

Section IV explains how the relevant competent authority for notification is defined

Section V provides for general principles and defines qualifying criteria of eligibility for the exemption from provisions of the Regulation

Section VI sets out the process for notification of the intent to use the exemption and its content, approach to processing notifications received by relevant competent authorities and assessing conditions of the exemption

Section VII clarifies the transitional measures

Section VIII prescribes what information has to be published by ESMA pursuant to Article 17(13) of the Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March on short selling and certain aspects of credit default swaps (the Regulation)

Annex I contains a list of the questions in the consultation paper

Annex II includes cost-benefit analysis

Annex III and Annex IV maintain common templates for notification of intent to make use of the exemption under Article 17(1) and Article 17(3) of the Regulation

Next steps

ESMA will consider responses it receives to this consultation and expects to adopt final guidelines in November 2012.

II. Background and Introduction

1. The Regulation published in the Official Journal of the European Union on 24 March 2012, will be applicable from 1 November 2012.
2. Article 17 of the Regulation provides for exemption for market making activities and primary market operations. Provisions of the Regulation prescribe the notification of intent to make use of the exemption to be made to the home authority of the notifying entity, while the exempted activities might also take place in other jurisdictions outside the supervisory remit of the home authority.
3. In order to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EEA, ESMA is working on the preparation of guidelines on market making activities as defined in Article 2(1) of the Regulation and on a common approach to the application of the exemptions under Article 17.
4. The purpose of these guidelines is to:
 - Assist the notifying entity in the notification process, by specifying and describing the content of the written notification and providing a template notification form;
 - Develop a common approach to submitting the notification form, assessing eligibility of the notifying entity's activities for the exemption and monitoring of the conditions of eligibility once the exemption is used.
5. According to Article 2(1)(k) 'market making activities' means the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC, which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:
 - a. by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
 - b. as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
 - c. by hedging positions arising from the fulfilment of tasks under points (a) and (b).
6. Article 2(1)(n) defines 'authorised primary dealer' as a natural or legal person who has signed an agreement with a sovereign issuer or who has been formally recognised as a primary dealer by or on behalf of a sovereign issuer and who, in accordance with that agreement or recognition, has committed to dealing as principal in connection with primary and secondary market operations relating to debt issued by that issuer.
7. Provisions of Article 17(1) exempt entities undertaking transactions due to market making activities from net short position transparency requirements and the restrictions on uncovered short sales. It should be emphasised that the exemption applies only to the transactions carried out in perfor-

mance of market making activities as defined above in paragraph 5(a) – (c); it does not apply to the entire scope of activity of the notifying entity.

8. According to Article 17(3) of the Regulation, persons exempted as authorised primary dealers as defined in Article 2(1)(n) are not required to notify net short positions in sovereign debt, are not subject to the restriction on uncovered short sales in sovereign debt instruments and are not prohibited to enter into an uncovered sovereign CDS transaction. It should be emphasised that the exemption does not apply to the entire scope of activity of the authorised primary dealers.
9. Use of exemptions under Articles 17(1) and 17(3) can only be made where previous notification of intent to make use of the exemption has been made in writing to the relevant competent authority at least 30 calendar days before the intended first use of the exemption.
10. The competent authority can prohibit the use of the exemption by the notifying person if it considers that the person does not satisfy the conditions of the exemption. The justified prohibition would be communicated in writing within the 30 calendar days upon having received complete notification including all relevant information as specified in paragraph 69. When the competent authority is satisfied the notification meets the conditions of the exemption, it may inform accordingly the notifying entity without having to wait for the 30 calendar days period to expire.
11. In addition, the concerned competent authority can, at any time, decide to withdraw the benefits of the exemption in case there have been changes in the circumstances of the natural or legal person so that it no longer satisfies the conditions of the exemption. This may result from the competent authorities own initiative and assessment or from a subsequent notification received under Articles 17(9) or (10) from the natural or legal person indicating a change affecting its ability to use the exemption.

III. Definition and scope of the exemption for market making activities

12. As stated in Section I, the exemption under Article 17(1) relates to the market making activities of a person that has properly notified the relevant competent authority and it is not an exemption of the person in question for all its activities. As recital 26 clearly states, such an exemption does not cover the proprietary trading of that person.
13. In order to ensure the exemption is applied in a uniform manner it is important to achieve a common understanding of the exempted activities. More precisely, in order to qualify for the exemption, market making activities have to be undertaken, whether on or outside a trading venue, by the following entities:
 - a. An investment firm which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k); or
 - b. A credit institution which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k); or
 - c. A third-country entity which is a member of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant

to Article 17(2), where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k); or

- d. A firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC, which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k).
14. As illustrated by the above, the market making activities of an entity as defined above in paragraph 5(a) – (c) are exempted if:
 - a. the entity is a member of a trading venue (or a market in a third country with declared equivalent regime) where
 - b. it deals (whether on the trading venue or OTC) as principal in
 - c. a financial instrument for which it claims the exemption.
 15. It should be noted that the exemption only covers activities when, in the particular circumstances of each transaction, they are genuinely undertaken in the capacity of market making as defined in Article 2(1)(k) of the Regulation. Consequently, persons notifying the intent to make use of the exemption are not expected to hold significant short positions, in relation to market making activities, other than for brief periods.
 16. Arbitrage activities (in particular those executed between different financial instruments but with the same underlying security) are not considered market making activities under the scope of the Regulation and therefore cannot be exempted.
 17. When carrying out hedging activities under Article 2(1)(k)(iii), the size of the position acquired for the purpose of hedging should be proportionate to the size of the exposure hedged in order for this activities to qualify for exemption. The person should be able to justify upon request from the competent authority why an exact match was not possible. The discrepancy should, in all cases, be insignificant.
 18. Concluding on the above, there are three preconditions for particular activities of an entity to be exempted from the Regulation's provisions:
 - a. being a member of the market on which it
 - b. deals as principal in one of the capacities defined in paragraph 5 above
 - c. in the financial instrument for which it notifies the exemption.
 19. Once the three conditions are fulfilled, market making activities of an entity in or related to the particular instrument may be exempted from Articles 5, 6, 7, 12, 13 and 14 of the Regulation, i.e. the transparency requirement relating to the net short positions in shares and sovereign debt, the restriction on uncovered short sales in shares and sovereign debt instruments and the prohibition to enter into an uncovered sovereign CDS transaction.
 20. However, the market making activities on sovereign CDS are not exempted from Article 8 of the Regulation, i.e. the notification to the competent authority of uncovered positions in sovereign CDS in

cases where the competent authority has suspended the restriction on such instruments in accordance with Article 14(2).

- **An exemption on per instrument basis**

21. Article 17(1) of the Regulation states that provisions of Article 5, 6, 7, 12, 13 and 14 shall not apply to transactions performed due to market making activities. According to Article 2(1)(k), market making activities, in their turn, are defined as dealing as principal in a financial instrument. Consequently, exemption under Article 17(1) applies to activities in a financial instrument, i.e. on an instrument per instrument basis, and should not be considered as a global exemption for market making activities in general. The notification submitted when notifying the intent to use the exemption under Article 17(1) and further use of this exemption should, therefore, concern a particular share or sovereign issuer, i.e.:
 - a. Shares of an issuer falling under the regime;
 - b. Sovereign debt issued by a sovereign issuer as defined by the Regulation;
 - c. CDS on sovereign debt of a sovereign issuer as defined by the Regulation.
22. Any such notification of the exemption should identify the individual instruments to which the exemption applies so that the Competent Authority can consider, on an instrument by instrument basis, whether to prohibit the use of the exemption pursuant to Article 17(7).
23. This approach is in line with the text of the Regulation. It should also be recalled that in accordance with the general principles on the interpretation of European legislation, constantly applied, that exemption included in a European legal text should be interpreted narrowly. Moreover, any other interpretation would be limiting the effectiveness of the Regulation - *de facto* enlarging without limits the operation of the exemptions.

- **Membership requirement**

24. Any natural or legal person intending to make use of the exemption for market making activities and notifying the relevant competent authority of its intention should be a member of a trading venue (i.e. a regulated market or a MTF as defined in Article 4(14) and 4(15) of Directive 2004/39/EC on markets in financial instruments) or of an 'equivalent' market in a third country where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(k).
25. In either case, the instrument which is the subject of the notification should be admitted to trading or traded on that venue or market of which that person is a member.
26. However, the notifying person is not required to conduct its market making activities solely on that venue or market or to be recognised as market maker or liquidity provider under the rules of that trading venue or market. Neither is there a requirement to have a separate contractual obligation to carry out market making activities.

- **Market making activities in related instruments**

27. It should be acknowledged that market making activities as defined in Article 2(1)(k) of the Regulation might be carried out not only on shares, sovereign debt or CDS on sovereign issuer but also on other financial instruments that are related to them.
28. A person who is performing market making activities on a financial instrument which is related (e.g. derivative) to a specific share, sovereign debt or CDS on sovereign issuer falling under the scope of the Regulation (related financial instrument) may notify its intent to use of the exemption provided that this notification identifies clearly:
 - a. Category of related financial instrument according to section C Annex I of MiFID on which the market making activities are carried out; and
 - b. the share(s), sovereign debt or CDS on sovereign issuer to which that financial instrument is related, as the person would have to trade on these instruments for hedging purposes.
29. In particular, a person's market making activities on derivatives and ETFs where, respectively, the underlying(s) of the derivative in question and the constituents of the concerned ETF are financial instruments falling within the scope of the regime could qualify for the exemption as long as trading in the relevant underlying is conducted for the purpose of hedging market making activities in related derivatives and ETFs.
30. Where the person notifies the intent to make use of the exemption for its market making activities on a related financial instrument, it should at least be member of a trading venue or an 'equivalent' third country market where that related instrument is admitted to trading or traded and where it deals as principal in that related financial instrument in any of the two capacities and related hedging activities specified in Article 2(k). It is not required for that person to also be a member of a trading venue or an 'equivalent' third country market where that underlying instrument (i.e. share, sovereign debt) is admitted to trading or traded.

Q1: Do you agree with the above approach regarding the definition and scope of the exemption for market making activities? Please, explain.

IV. Determination of the competent authority that should be notified

31. The Regulation specifies to which competent authority a natural or legal person should notify its intention to make use of an exemption for market making activities or as an authorised primary dealer. However, there is a distinction between a third country entity not authorised in the Union and other persons, authorised, registered or domiciled in the Union.
32. For persons domiciled in the Union, the relevant competent authority for notification (RCA) is:
 - for the exemption for market making activities, the competent authority of the home Member State of that person as defined in Article 2(1)(i) of the Regulation;
 - for the exemption as authorised primary dealers, the competent authority of the Member State of the concerned sovereign debt.
33. For a third country entity not authorised in the Union (third country entity), Article 17(8) of the Regulation defines the RCA as that of the main trading venue in the Union in which it trades. Two

specific situations should be considered, taking into account the spirit of the Regulation, the need for consistency with the approach for EU persons and the objective to provide a workable and practical framework not entailing confusion for third country entities as to the identification of the RCA.

34. Where a third country entity intends to make use of the exemption as authorised primary dealer or for market making activities for a specific sovereign debt or CDS on sovereign debt of a sovereign issuer, it should notify the RCA of the sovereign debt concerned as defined in Article 2(1)(j) of the Regulation and as identified on the ESMA website (list of notification thresholds for sovereign issuers and RCAs, under Article 7(2)).
35. Considering the limited number of sovereign issuers, a separate entry point in Europe per sovereign issuer is manageable. From the third country entity's perspective, there will be clarity and certainty as to the identity of the RCA. No quantitative assessment of the trading activity should then be conducted to determine the main trading venue, a process that would be otherwise confusing, taking into account that sovereign debt is largely traded OTC.
36. From a supervisory perspective, centralisation at the level of the RCA for a given sovereign issuer will provide for a consistent processing of the notifications and monitoring of the use of the exemption. The overall process will be simplified.
37. Where a third country entity intends to make use of the exemption for market making activities for a specific share, it should notify the RCA authority of the trading venue where it carries out most of its trading activities in shares in Europe.
38. The third country entity should assess its activity in the course of the preceding year on the basis of the turnover (as defined in Article 2(9) of Commission Regulation (EC) No 1287/2006) per trading venue when performing market making activities in shares in Europe and identify on which European trading venue (i.e. regulated market or MTF) it is the most active.
39. This would provide each third country entity with a single entry point within Europe, a single European competent authority to which the notification should be addressed, irrespective of the share concerned. It would be in line with the definition of the relevant CA for EU persons, i.e. the CA of the home Member State (Art. 17(5)) on the assumption that the home Member State is the place where the persons domiciled in the Union is doing the bulk of its business).

Q2: Do you agree that when determining the RCA for notification purposes the third country entity should assess the turnover in relation to its market making activities as defined in Article 2(1)(k) of the Regulation? Please, explain,

V. General principles and qualifying criteria of eligibility for the exemption

40. The below principles and criteria are not intended to supplement or change the definition of market making activities¹, but rather set the standards that competent authorities shall take into account

¹ In particular, these criteria do not intend to broaden or narrow the scope of market making as defined currently in MIFID or as it will be defined following the MIFID review.

when assessing whether an entity notifying an exemption under article 17(5) of the SSR is entitled to benefit from it.

V.I. General principles

41. A person, as defined above, that intends to use the exemption set out in Article 17(1) of the Short Selling Regulation must:
- be a member of the trading venue where the financial instrument in question is admitted to trading or traded and in which it conducts a market making activity on that instrument;
 - comply with the general rules and particular requirements for market making activities imposed by the trading venue or market in the third country;
 - implement separate arrangements for the middle and back-office with respect to the market making activities for which it claims the exemption;
 - maintain its records of orders and transactions relating to its market making activities for which it requests the exemption separately from its records of its proprietary trading activities;
 - possess effective compliance and audit resources and a framework to enable it to monitor the market making activities for which it requests the exemption;
 - be able to demonstrate at any time to the competent authority that its market making activity meets the principles and criteria in the Guidelines.

Q3 Do you agree with general principles applicable to persons intending to make use of the exemption under Article 17(1) of the Regulation? Please, explain.

V.II. Principles that should apply when “posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market” (Article 2(1)(k)(i))

42. The over-riding applicable principle is that market making activity must provide liquidity to the market.
43. A person undertaking market making activities must be present on the order book for the relevant financial instrument(s) for which it requests the exemption for a sufficient proportion of the mandatory trading period such that investors can observe, during the whole trading session, the existence of an effective bid/ask spread with proposed competitive prices. Time presence should be expressed as a percentage of the total duration of the trading session, but may vary according to both the trading venue or an ‘equivalent’ market in a third country and the financial instrument in question.
44. Presence should be assessed taking into account the time that the person has a bid and an offer within the relevant price and size parameters for the given financial instrument on the relevant order book or quote book.
45. Bid and offer quotes entered by the person that can be taken into account when determining ‘presence’ on the order book or quote book must:

- a. Be displayed on the order book or quote book;
- b. Option 1: Be in proportion to the average spread of the considered instrument and competitive enough to enhance liquidity;
- c. Option 2: Be conducted at prices that fall within a maximum acceptable spread;
- d. Be of a minimum size in proportion to the average traded size of the instrument on the trading venue.

Q4 Do you agree with principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(i) of the Regulation? In your view which of the two options in paragraph 44 should apply to quotes entered when carrying out market making activities? Do you see another alternative to the two options proposed? Please, provide explanations.

V.III. Principles that should apply when dealing “as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade” (Article 2(1)(k)(ii))

46. In addition to the general principles set out in paragraph 41, for dealing as a principal when fulfilling clients' orders or responding to clients' requests to constitute market making activities for the purposes of the Regulation, a person must demonstrate to the competent authority that it is an investment firm, credit institution, a third country entity or a firm as referred to in point (1) of Article 2(1) of Directive 2004/39/EC and that such dealing is and will be part of its ‘usual business’.

47. As such, the competent authority will take into account issues including:

- Whether, and to what extent, the person already deals on a frequent and systematic basis in the financial instrument in question when fulfilling client orders or responding to clients' requests. It should be noted that activity performed on an ad hoc and irregular basis will not be considered to constitute ‘usual business’ qualifying for the purpose of exemption;
- The scale of activity (for which the exemption is notified) in comparison to overall proprietary trading of the person;
- Where the person does not yet deal on a frequent and systematic basis in the financial instrument in question to fulfil client orders or to respond to clients' requests:

whether it has a reasonable expectation that it will do so in the future, and the basis for that expectation and the business assumptions that justify it (including in relation to its dealing for clients in other financial instruments). Reasonable expectation of dealing in a particular financial instrument can be referred to in a notification to CAs. However, for a firm’s dealing “as part of its usual business...” to be exempted as market making activity, it must be fulfilling actual client orders or responding to actual client requests to trade. Dealing as principal in anticipation of client orders or requests would not be exempt under this limb of the exemption.

Q5 Do you agree with the principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(ii) of the Regulation? Please, explain.

V.IV. Qualifying criteria applicable to activities under Article 2(1)(k)(i)

48. ESMA considers it appropriate to include in these Guidelines the criteria against which competent authorities should assess notifications submitted under article 17(5).

49. It is ESMA's view that such assessment criteria are only relevant to determining whether the conditions in article 2(1)(k)(i) are met. These conditions relate to:

○ **The comparable sizes of orders:**

50. Market making activity would undermine the orderly functioning of the markets if it leads to an increase of market fragmentation due to small orders posted by a market maker. In this context, the size of the orders issued in the market making capacity has to be assessed in consideration of the average trading size (ATS) for the said financial instrument on a specific venue and should not be smaller.

Q6 Do you agree with the qualifying criteria for the comparable size of orders? Please explain.

○ **The competitive prices of orders:**

51. A competitive price is closely related to the intrinsic liquidity of the financial instrument concerned. Because liquid shares under MiFID generally have intrinsic liquidity, prices of market makers should be considered competitive if they are measured:

a. Option 1: as a proportion of the average spread observed on the relevant financial instrument on the platform on which the instrument is negotiated or

b. Option 2: as a percentage of the price of the instrument in question.

52. In some respects, some might consider that market making activities are not necessary in respect to financial instruments where the market is already highly liquid. In this context, the requirement applying to persons who claim for the exemptions in relation to market making activities in highly liquid shares should be notably more demanding.

53. Moreover, considering that the Regulation does not specify if the prices that are posted have to be similarly competitive on buy/sell, the bid-ask range proposed by the person conducting market making activities can obviously be asymmetrical, that-is-to-say that it can be moved away from the central point of the market bid-ask range being posted for the relevant financial instrument. The competitiveness of the prices can therefore be different on bid and ask at a given time according to the directional side of its strategy, as long as the entity undertaking market making activities complies with the aim of providing liquidity to the market.

Q7 Do you agree with the qualifying criteria for competitive price of orders? Please explain.

Q8 Which option do you favour? Please, justify.

- **A regular and ongoing presence on the market:**

54. In this regard, the Regulation does not appear to require an uninterrupted presence though it provides that the presence should be regular and ongoing. Therefore, presence on the market should consist of:
- a. conducting qualifying activities each day the market is open;
 - b. submitting orders that meet the above-mentioned criteria, according to a reasonable frequency, that is to say that, it does not interrupt the market making activity for a significant period of time during a single trading session.
55. Considering the above, a regular and ongoing presence on the market would mean that market making activities should on monthly basis be undertaken for at least 90% of the overall trading time on a given financial instrument.
56. For financial instruments whose price is determined solely by auction, the concept of regular and ongoing time presence does not have a meaning comparable to that prevailing for financial instruments for which trading is carried out on a continuous basis. However, to claim for the exemption for market making activities for these instruments, the person should issue competitive buy and sell orders for a sufficient time when the pre-opening phase of the auction is organised and should remain on the market until the closing price for the instrument is determined.

Q9 Do you agree with the qualifying criteria for ongoing presence on the market? Do you think different criteria should apply when conducting market making activities in sovereign debt? Please explain.

57. Critically, these three criteria are not independent of each other but interact with one another. Market making activities under article 2(1)(k)(i) that are exempt under Article 17 will be those where a person is offering prices that are competitive and in comparable sizes, in line with the criteria above, for at least the indicative percentage of mandatory trading time.
58. An entity may demonstrate that it meets these criteria by reference either, *ex post*, to historical trading or, *ex ante*, to trading it intends to conduct in future.
59. ESMA proposes that competent authorities take the following approach towards assessment of notification of intent to make use of the exemption:
- a. Where a person can demonstrate that it is party to a market making or liquidity provision contract or programme with a trading venue or an issuer which meets or exceeds the above three criteria there is a presumption that its notification should be accepted by the competent authority. It should be noted that regardless of being a party to the contract, the person should, nevertheless, fulfil relevant criteria under Article 2(1)(k), e.g. be a member of a trading venue, deal as principal, etc.;
 - b. Where a person is not party to a contract or programme as described above it should provide evidence that it deals as principal on a trading venue in accordance with the criteria set out above.

60. Further, the notifying person should be in a position to provide additional information or evidence upon ad-hoc request from the competent authority. In particular:
- a. Evidence of comparable size of orders;
 - b. Evidence of competitive prices of orders;
 - c. Evidence of regular and ongoing presence on the market.

Q10 Do you agree with the ESMA approach towards assessment of notification of intent to make use of the exemption? Please explain.

V.V. Qualifying criteria applicable to activities under Article 2(1)(k)(ii)

61. Principles applicable to market making activities under Article 2(1)(k)(ii) capacity include frequency and systematic basis with which the relevant activity is carried out, as well as the scale of this activity in comparison to overall proprietary trading.

Q11: Would you agree that frequency and systemic basis of the activities exempted under Article 2(1)(k)(ii) capacity should be assessed against the same qualifying criteria as applicable to systemic internalisers under Article 21(1) of the Commission Regulation (EU) No 1287/2006? Please, provide explanations.

Q12: In your opinion, what would be the most appropriate qualifying criteria in terms of percentage to assess scale of activity eligible for exemption under Article 2(1)(k)(ii) capacity in comparison to overall proprietary trading?

VI. Exemption process

62. The use of the exemption under the Regulation is based on the requirement for notification of the intent. It is not an authorisation or licensing process. However, the notified competent authority may prohibit the use of the exemption, either at the time of the notification or subsequently, if it considers that the conditions of the exemption are no longer fulfilled.
63. Considering the wide geographical scope of the exemption for a specific financial instrument and the potential impact on the European markets, the single competent authority which receives the notification for that instrument is accountable for its decision as to whether or not to prohibit its use.
64. Besides, according to the Regulation, the onus for prohibiting the use of the exemption is on the competent authority that was notified. Therefore, ESMA considers that any decision by that competent authority to refuse the benefit of the exemption to a person should be justified and made in writing.
65. Depending on national laws and regulations and though not required by the Regulation, a competent authority which is notified of the intent to use an exemption may formally respond to the notifying person that it does not object to the use of that exemption.
66. In this context, it is therefore crucial to have a harmonised application of the provisions of the Regulation relating to (a) the notification of the intent to use the exemption (b) its content (c) the approach to processing notifications received by relevant competent authorities and (d) the approach to

assessing conditions of the exemption which may result in the decision by a competent authority to prohibit its use of exemption, including the criteria to consider, whether it be at the time of the initial notification or subsequently.

- **Notification of intent**

67. The common approach to requirements for information provided in the notification of the intent to use the exemption should be balanced so as to ensure that competent authorities are provided sufficient information. This information should allow them to implement an efficient notification assessment process and at the same time avoid imposing disproportionate notification requirements on persons intending to make use of the exemption.
68. The notification has to be submitted to the relevant competent authority in writing, in accordance with the template provided in Annex III and IV, in the language(s) accepted by the competent authority in that Member State. Should additional accompanying documents be provided, they can be submitted in a language which is customary in the sphere of international finance.
69. Depending on the type of exemption (Authorised Primary Dealers or Market Making activities), the notifying entity should provide the following information:
 - a. For Authorised Primary Dealers:
 - i. Details of the notifying party;
 - ii. Details of the contact person within the notifying party;
 - iii. Copy of the agreement/recognition signed with a sovereign issuer or a person acting on its behalf.
 - b. For market making activities:
 - i. Details of the notifying party;
 - ii. Details of the contact person within the notifying party;
 - iii. Status of the notifying party:
 1. Credit institution;
 2. Investment firm;
 3. Third country entity; or
 4. Firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC.
 - iv. Market of which the notifying person is a member;
 - v. A description of the activities specifying particular capacity according to Article 2(1)(k) of the Regulation:

1. Capacity under Article 2(1)(k)(i);
2. Capacity under Article 2(1)(k)(ii) and the nature of client facilitation services:
 - a. Fulfilling orders initiated by clients;
 - b. Responding to clients' requests to trade.
- vi. For each capacity, the financial instrument(s) for which the intent to use the exemption is notified. It can take the form of a list of individual financial instruments or a clear specification of the instruments concerned, provided that it results in a closed list of specific instruments and allows the notified competent authority to unambiguously identify all individual instruments for which the exemption is declared;
- vii. In case of existing contractual agreement for provision of market making services – description of the main duties and activities under the contract or a copy of the contract;
- viii. Where the market making activities are carried out on related instruments, e.g. ETFs – the corresponding category of financial instruments according to Section C Annex I of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments (MiFID), e.g. category 3 – units in collective investment undertakings;
- ix. Where no previous market making activity in a particular financial instrument can be demonstrated (e.g. IPO, intention to start a new market making business in a new financial instrument, etc.):
 1. For market making activities under Article 2(1)(k)(i) capacity – indication of expected daily volumes of market making activities in a financial instrument;
 2. For market making activities under Article 2(1)(k)(ii) capacity – indication of expected weekly volumes of market making activities in a financial instrument.

Q13 Do you agree that the above information needs to be provided in the notification form? Should historical data be also provided with the notification form? Please, provide justifications.

70. For the authorised primary dealer or market making activities exemption, the status of the notifying party (investment firm, credit institution, market member) is a condition that should be clearly assessed and cross-checked.
71. It should be noted that such an assessment may be more complex for third country entities: beyond ensuring that the third country market of the applicant is declared equivalent, cooperation and exchange of information with third country regulators may be necessary and will be carried out according to provision of Article 38 of the Regulation.

- **Monitoring of the conditions of the exemption**

72. In accordance with Article 17(10) a person who has given a notification under paragraphs 5 or 6 of Article 17 shall as soon as possible notify in writing the competent authority of its home Member State where there are any changes affecting that persons eligibility to use the exemption. In light of the notified changes, the competent authority shall assess within two weeks whether the relevant activities still qualify for the exemption.
73. As part of common supervisory approaches and practices, competent authorities might on their own initiative carry out thematic reviews to verify at any time whether activities of the natural or legal person satisfy the conditions of exemption.

Specific situation of emergency measures

74. When in exceptional circumstances a competent authority is introducing a temporary measure exercising its powers under Chapter V Section 1 of the Regulation that goes beyond the regular regime, it may decide to exempt market making activities or primary dealing activities from the measures. This is a discretionary power left to the authority introducing the measure. In particular, the competent authority might exercise a certain level of discretion when providing for such exemption. Without prejudice to further exceptions being specified by a CA, when an exception applies to market making activities, the latter should be understood as defined in the Regulation.

Cooperation between competent authorities

75. As provided for in the Regulation the exemption is granted by the home competent authority of the notifying person and it must be accepted throughout the Union.
76. However it is possible that for certain financial instruments the local authority of the market (which is the host authority for the notifying person) may receive more comprehensive data in order to verify the actual performance of market making activities for which the person is exempted. Namely, while performing a day-to-day supervisory function of the trading activities on the local market, the host authority might come across evidence of suspected non-compliance with the conditions for exemption for market making activities by a particular person. In such a case the host authority will submit relevant evidence to the home authority.
77. The home competent authority, having considered and analysed the evidence provided, shall undertake further cooperation in accordance with Articles 35 and 37 of the Regulation.
78. Disagreements between the competent authorities shall be settled according to provisions in Article 19 of the ESMA Regulation (EU) No 1095/2010.

VII. Transitory measures

79. According to Article 17(14) of the Regulation notification to a competent authority may be made at any time within sixty calendar days before 1 November 2012. Nevertheless, notifications made before entry into force of the Guidelines and not in compliance with requirements set herein shall be reviewed? and assessed against the provisions contained in the guidance within 6 months after application of the Guidelines.

80. It should be noted that the Regulation does not contain a grandfathering clause for market making exemptions granted before its application. Therefore, entities whose activities are currently exempted from national short selling regimes should notify the relevant competent authorities in writing of their intention to make use of exemption under Article 17(1) of the Regulation.

Q14: Do you agree with a period of 6 months after application of the Guidelines for revising and assessing notifications made before entry into force of the Guidelines? Please, explain.

VIII. Information to be published by ESMA on its website in accordance with Article 17(13)

81. The information to be published should at least include :

- a. Competent authority to which the exemption was notified;
- b. For third country entities – competent authority of the trading venue on which the entity is most active when performing market making activities;
- c. The identification of the exempted person (including an ID code such as BIC);
- d. The financial instrument(s) for which the exemption is used;
- e. Trading venue of which the exempted person is a member and on which the relevant financial instrument is admitted to trading or traded.

Q15: Do you agree that a list of market makers and authorised primary dealers published on the ESMA website according to Article 17(13) should at least include the above information? What additional information should be included? Please justify.

Annex I

Summary of questions

- Q1:** Do you agree with the above approach regarding the definition and scope of the exemption for market making activities? Please, explain.
- Q2:** Do you agree that when determining the RCA for notification purpose the third country entity should be assessing the turnover in relation to its market making activities as defined in Article 2(1)(k) of the Regulation? Please, explain,
- Q3** Do you agree with general principles applicable to persons intending to make use of the exemption under Article 17(1) of the Regulation? Please, explain,
- Q4** Do you agree with principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(i) of the Regulation? In your view which of the two options in paragraph 44 should apply to quotes entered when carrying out market making activities? Do you see another alternative to the two options proposed? Please, provide explanations.
- Q5** Do you agree with the principles applicable to persons carrying out market making activities in accordance with Article 2(1)(k)(ii) of the Regulation? Please, explain.
- Q6** Do you agree with the qualifying criteria for the comparable size of orders? Please explain.
- Q7** Do you agree with the qualifying criteria for competitive price of orders? Please explain.
- Q8** Which option do you favour? Please, justify.
- Q9** Do you agree with the qualifying criteria for ongoing presence on the market? Do you think different criteria should apply when conducting market making activities in sovereign debt? Please explain.
- Q10** Do you agree with the ESMA approach towards assessment of notification of intent to make use of the exemption? Please explain.
- Q11:** Would you agree that frequency and systemic basis of the activities exempted under Article 2(1)(k)(ii) capacity should be assessed against the same qualifying criteria as applicable to systemic internalisers under Article 21(1) of the Commission Regulation (EU) No 1287/2006? Please, provide explanations.
- Q12:** In your opinion, what would be the most appropriate qualifying criteria in terms of percentage to assess scale of activity eligible for exemption under Article 2(1)(k)(ii) capacity in comparison to overall proprietary trading?

- Q13** Do you agree that the above information needs to be provided in the notification form? Should historical data be also provided with the notification form? Please, provide justifications.
- Q14:** Do you agree with 6 months after application of the Guidelines period for revising and assessing notifications made before entry into force of the Guidelines? Please explain.
- Q15:** Do you agree that a list of market makers and authorised primary dealers published on the ESMA website according to Article 17(13) should at least include the above information? What additional information should be included? Please justify.



Annex II

Cost-benefit analysis

The impact assessment of exemption for market making activities and certain primary market operations was carried out by the European Commission when adopting a proposal for a regulation on short selling and certain aspects of Credit Default Swaps (CDS). Policy options assessed in that impact assessment included, among other, the requirement for advance notification of the intent to make use of the market making and/or authorised primary dealer exemption. The impact assessment may be found under the following link:

http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_impact_assessment_en.pdf



Annex III

Notification of intent to make use of the exemption under Article 17(3) of Regulation (EU) No 236/2012 of the European Parliament and the Council of 14 March 2012 on short selling and certain aspects of Credit Default Swaps

NOTIFYING PARTY	First name LAST NAME Full company name		
	BIC code (if the holder has one)		
	Country		
	Address		
	Contact person	First name Last name	
		Phone number	
		Fax number	
	E-mail address		

IMPORTANT:

This notification form is only valid if submitted together with a copy of the agreement/recognition signed with a sovereign issuer or a person acting on its behalf

Annex IV

Notification of intent to make use of exemption the under Article 17(1) of Regulation (EU) No 236/2012 of the European Parliament and the Council of 14 March 2012 on short selling and certain aspects of Credit Default Swaps

NOTIFYING PARTY	First name LAST NAME Full company name	
	BIC code (if the holder has one)	
	Country	
	Address	
	Contact person	First name Last name
		Phone number
		Fax number
	E-mail address	

STATUS	
MARKET MEMBERSHIP	
DESCRIPTION OF ACTIVITIES ACCORDING TO ARTICLE 2(1)(K)	
FINANCIAL INSTRUMENT(S)	
DESCRIPTION OF CONTRACTUAL AGREEMENT	
CATEGORY OF RELATED INSTRUMENT	
INDICATION OF EXPECTED ACTIVITIES	